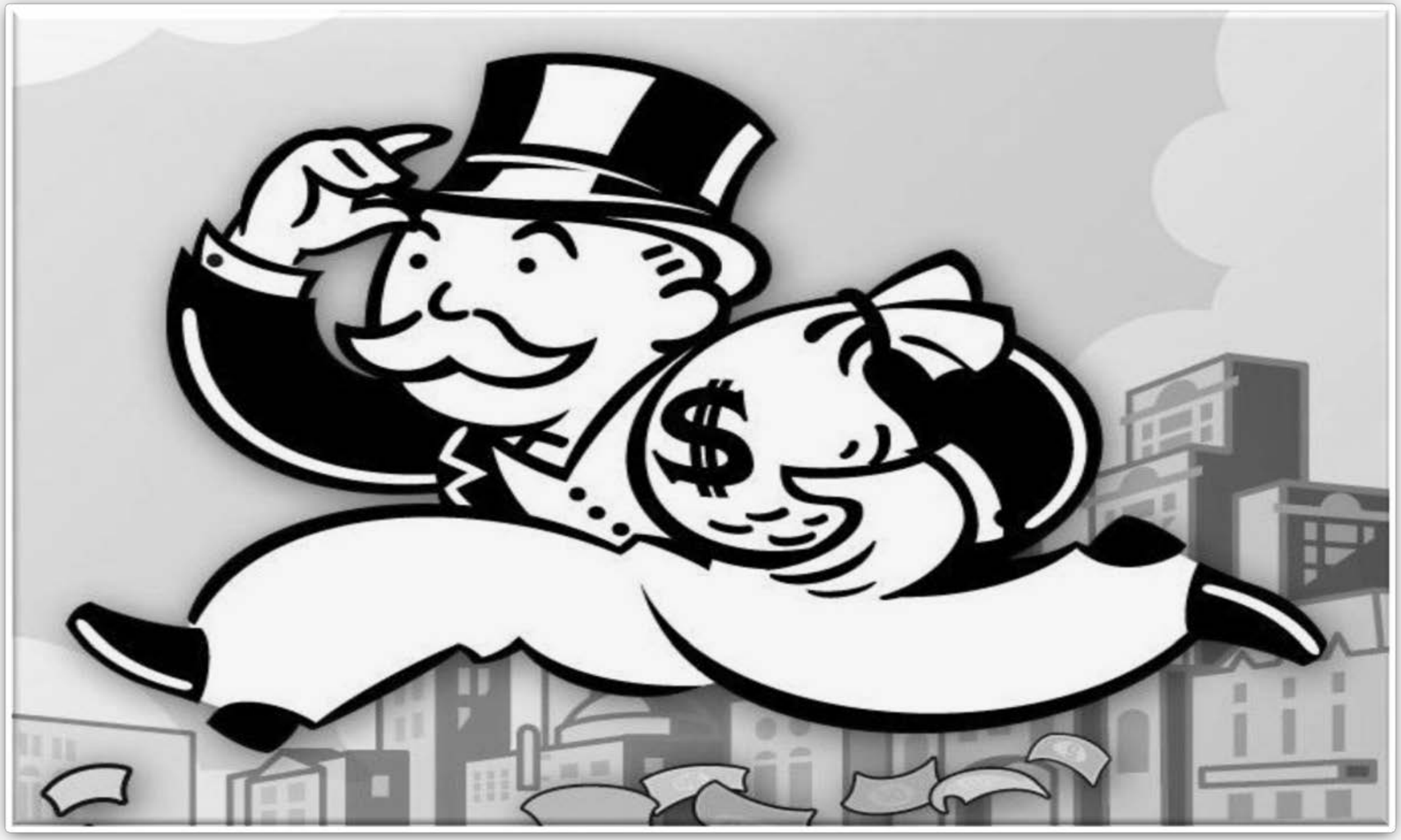

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GLOBAL REGULATION OF TAX HAVENS

USA AND ITS CHANGING ROLE IN THE REGULATION OF THE OFFSHORE ECONOMY

CITY UNIVERSITY OF HONG KONG

PRESENTATION OUTLINE

- A) Tax Havens and their systemic connection
- B) Struggles over the enforcement of the US tax system
- C) Concluding takeaways and implications

A) 1. THE RISE OF TAX HAVENS

- Some of the oldest legislative acts trace back to **1869** (Monaco), **1875** (New Jersey), **1898** (Delaware), **1926** (Liechtenstein), **1929** (Luxembourg), and **1934** (Switzerland)

- Modern day proliferation is tied to three phenomena:

  1) **Globalization** and the advances in transportation and communication technologies

  2) **Decolonization** in the 1960s (new countries looking for niches in the global market)

  3) **A 1957 Bank of England ruling**, which decreed "that transactions undertaken by UK banks on behalf of a lender and borrower who themselves were not located in the UK were not to be officially viewed as having taken place in the UK for regulatory purposes even though the transaction was only ever recorded as taking place in London" - such transactions thus became effectively unregulated or 'offshore'. This was likely an unintended consequence of trying to cope with increasing financial complexity, but **led to the undermining of the Bretton Woods system**.

A) 2. CLASS CAMPAIGN

- 1947 – Mont Pelerin Society – Hayek & Friedman commence their battle of ideas ultimately leading to the rise of neoliberalism

- Enormous sums of money marshaled for the neoliberal/libertarian cause, paid for by:

  - leading Fortune 500 companies (GM, Chrysler, Ford, Gulf Oil, Standard Oil, Sun Oil, US Steel, National Steel, Republic Steel, Montgomery Ward, Marshall Field, Sears, Monsanto, DuPont, General Electric, Merrill Lynch, Eli Lilly, BF Goodrich, ConEd, …)
  - wealthy individuals (Joseph Coors, …)
  - their foundations (Olin, Scaife, Smith Richardson, Pew Charitable Trust, …).

- These funds were used to establish and/or fund:

  - neoliberal/libertarian think tanks (Heritage Foundation, Hoover Institute, Center for the Study of American Business, American Enterprise Institute, National Bureau of Economic Research, Cato Institute, …)
  - economics departments and business schools (University of Chicago, …)
  - the dissemination of numerous materials ranging from books (Robert Nozick's Anarchy, State, and Utopia, …) to TV shows (Milton Friedman's Free to Choose, …).

A) 3. THE NEW “COMMON SENSE”

- The new “common sense” applied by Thatcher (1979) in UK, Reagan (1981) in USA
- Spread throughout the former Bretton Woods institutions (IMF, WB, WTO) and other US-dominated expert bodies (OECD) => “Washington Consensus”
- Neoliberalism:
  - a form of market fundamentalism that mandates fiscal policy discipline, restructuring of public expenditure priorities, lower taxes, fostering ever-higher degrees of competitiveness, encouragement of FDI, trade liberalization, privatization, and deregulation.
  - based on a "systematic use of state power to impose, under the veil of “non-intervention”, a hegemonic project of recomposition of capitalist rule in most areas of social life".
- With the fall of the Soviet Union and the decimation of Western labor movements and their traditional social democratic party allies, capitalism has lost its opposition and restraint => systemic instability, inequality, environmental degradation, …

A) 4. TAX HAVENS AND THEIR IMPACT

- Tax havens have not only inadvertently helped neoliberalism rise, but have played an important role in the numerous crises facing the system today.
  - Systemic instability (global financial crisis) - applying competitive pressures to deregulate, providing secrecy to various shadow banking entities like SPVs, SIVs and hedge funds
  - Inequality - concentration of wealth through tax dodging by the world's wealthiest individuals and corporations, granting them outsize political power
  - Environmental degradation - tax avoidance schemes create a competitive advantage for the largest corporations with a vested interest in fossil fuels
- As of 2010, **21-32 trillion USD** of financial assets stashed “offshore”.
  - EU estimates losing about **1 trillion EUR** annually to tax dodging
  - Developing world estimated to lose about **200 billion USD** annually to tax dodging
  - USA estimated to lose about **185 billion USD** annually to tax dodging

=> **How have they managed to survive?! How is it that they continue to thrive?!**

B) 1. US STRUGGLE AGAINST TAX HAVENS

- 1913 - federal taxes become a permanent fixture with the ratification of the 16th Amendment to the Constitution.
- USA has a citizenship-based system as opposed to a territory-based one - applying to all US citizens and corporations wherever they may be, and was levied on the entire net income arising or accruing from all sources, including foreign income.
- Tax abuse a problem from the very beginning, mentions as early as the 20s and a serious inquiry as part of the New Deal reforms in 1937.
- Kennedy (1961) recommended the "*elimination of the "tax haven" device anywhere in the world, even in the underdeveloped countries, through the elimination of tax deferral privileges for those forms of activities, such as trading, licensing, insurance and others, that typically seek out tax haven methods of operation.*" But what about **competitiveness**?!

B) 2. US STRUGGLE AGAINST TAX HAVENS

- 1981 – the Gordon report

- In **1968**, the total assets of tax haven based foreign corporations controlled by US corporations was **US$ 11.7 billion**, rising to **US$ 55.4 billion** in **1976**.

- Direct investment into tax haven based subsidiaries rose from **US$ 4.7 billion** in **1968** to **US$ 23 billion** in **1978**.

- Earnings of tax haven entities increased from **US$ 0.5 billion** in **1968** to **US$4.4 billion** in **1978**.

- Deposits in tax haven banks have grown from **US$ 11 billion** in **1968** to **US$ 385 billion** in **1978**.

- Problem: lack of information exchange
- Solution: a coordinated multilateral attack on tax havens
- But what about **competitiveness**?!

B) 3. THE ATTACK OF THE ALPHABET

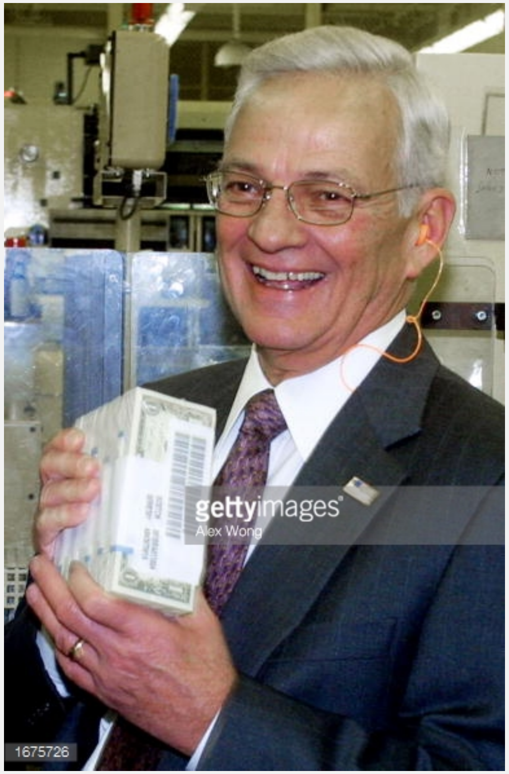
- 1990s – **G7** tasks the Financial Action Task Force (**FATF**), Financial Stability Forum (**FSF**) and Organization for Economic Cooperation and Development (**OECD**) to look into tax havens. USA under the Clinton administration a strong proponent of the effort.
- 1998 – **OECD** launches the Harmful Tax Competition Initiative (**HTCI**), finding that : "*tax schemes aimed at attracting financial and other geographically mobile activities can create harmful tax competition between States, carrying risks of distorting trade and investment and could lead to the erosion of national tax bases*".
- Switzerland and Luxembourg publicly denounce the report and refuse to be bound by any of its provisions. Tax havens ask: But what about **competitiveness**?! => Isle of Man clause.
- The very phrase "**harmful tax competition**" and "**unfair tax competition**" comes under attack and is purged in all future documents, replaced by "**harmful tax practices**".
- OECD forced to admit the mistake under intense pressure: "*As an economist, how can you ever say anything bad about competition?*"

B) 4. THE ATTACK OF THE ALPHABET

- Intense lobbying effort by neoliberal/libertarian think tanks, banks and financial institutions gains support of 86 Republican Congressmen and several high ranking officials in the new Bush administration.

- May 2001 – US Secretary of the Treasury Paul O'Neill lambasts OECD and derails the campaign.

- "*I share many of the serious concerns that have been expressed recently about the direction of the OECD initiative. I am troubled by the underlying premise that low tax rates are somehow suspect and by the notion that any country, or group of countries, should interfere in any other country's decision about how to structure its own tax system. I also am concerned about the potentially unfair treatment of some non-OECD countries. The United States does not support efforts to dictate to any country what its own tax rates or tax system should be, and will not participate in any initiative to harmonize world tax systems. The United States simply has no interest in stifling the competition that forces governments - like businesses - to create efficiencies.*"



B) 5. THE FATCA GAMECHANGER

- 2010 – Foreign Account Tax Compliance Act (FATCA) enacted.
- It asks all foreign financial institutions (FFIs) anywhere in the world to register with the IRS and report the relevant account information of all their US clients.
- Joining FATCA is **voluntary**, BUT, non-participation is treated with an automatic **30% withholding tax** on certain payments of US source income (e.g. dividends, interest, insurance premiums)
- Participating FFIs also required to withhold 30% on these payments to non-participating FFIs, widening the web.
- FATCA served as an inspiration to the G20/OECDs recent Common Reporting Standard (automatic exchange of information with a global ambition)
- A success story? Could FATCA be internationalized?

C) 1. CONTECTUALIZING FATCA

- 1) FATCA and the historically unprecedented post-crisis regulatory advances impressive ONLY when compared with the impotence of the past. When compared with what needs to (and objectively CAN) be done, they fall way short of their task, achieving a reshuffling of illicit financial flows rather than a stifling.

- 2) Capital as a political force materially as strong as it ever was, and growing stronger each year. Neoliberalism as an ideological project dying, delegitimized by the global financial crisis, but with the absence of a credible mainstream alternative, or a political force willing to implement it, neoliberalism continues to thrive even as it is dying => zombie neoliberalism.

C) 2. CONTECTUALIZING FATCA

- 3) FATCA emerged under extremely serendipitous circumstances, and even with everything going for it barely passed.

	TOTALS		DEMOCRAT	REPUBLICAN
AYE	217	50%	217	0
NO	212	49%	37	175
NOT VOTING	6	1%	3	3
REQUIRED:	Simple Majority			

Republicans active in seeking its repeal, or at least in weakening its effectiveness => Despite each additional US $1 spent on tax enforcement yielding US $6 or more in collected revenue, the American **IRS** has suffered severe spending cuts. Since 2010, **funding was cut by 18%**, and **more than 13 000 employees fired**.

C) 3. CONTECTUALIZING FATCA

- 4) Problem of compliance and enforcement.
- 5) FATCA likely to face growing resentment and pushback by other countries as well. The Intergovernmental Agreement (IGA) between USA and Canada regarding FATCA challenged in the Federal Court.
- 6) USA itself comprises of a number of tax free and secrecy jurisdictions. Its past conduct, both under the Democrats and the Republicans, already contains precedents for being particularly interested in finding its own tax cheats, but happy to invite and cater to foreign ones. Not committing to the OECD's new efforts to enact a global automatic exchange of information is hinting in exactly this direction.

=> FATCA's very future is a big IF, and its effectiveness a bigger one. We are still at the beginning, with no end in sight.

C) 4. OBSERVATIONS / TAKEAWAYS

- 1) Business lobbies (financial industry, big business, big 4) and their ideological (neoliberal/libertarian) think tank allies have been remarkably successful in derailing or watering down regulatory efforts.

- 2) Democratic administrations generally led the way in commissioning the most damning reports, inquiries and bills against tax havens. Republican administrations invariably heeded the cries of the lobbies and stood in the way.

- 3) Despite intermittent lip service paid to multilateral solutions and one genuine but brief effort in 1998 (HTCI), US approach thoroughly unilateral, selfserving, and gradually intensifying.

- 4) Language and the power of Capital to appropriate and apply meanings, interpretations and logics, to control the dominant narrative and impose their version of the "common sense" a key strategy.

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